

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE NKETOANA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Nketoana Local Municipality which comprise the balance sheet as at 30 June 2008, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in accounting policy note 1.

Basis for disclaimer of opinion

Property Plant and Equipment

5. For reasons as detailed below I was unable to obtain adequate audit assurance as to the existence, rights, completeness and valuation of fixed assets amounting to R316 544 893 (2007: R217 996 575) and loans redeemed and other capital receipts amounting to R306 149 569 (2007: R207 294 667) as disclosed in note 6 to the financial statements:

- The municipality did not maintain a reliable record of fixed assets that contained all relevant information to determine the source of funding of assets and that allowed for the proper identification and verification of fixed assets
- Properties identified on the rateable valuation reconciliation, registered in the name of the municipality to the value of R2 131 080 were not recorded in the fixed asset register.

Due to the extent of the weaknesses in the fixed asset records of the municipality I could also not perform reasonable alternative procedures to obtain adequate audit assurance as to the existence, rights, completeness and valuation of fixed assets.

Cash and cash equivalents

6. Due to a lack of controls over the timely identification and clearing of unknown deposits received in the bank account, cash and cash equivalents as disclosed in the balance sheet and in note 13 to the financial statements were understated by R5 368 607. Due to a lack of information, I could not determine whether the deposits not recorded amounting to R5 368 607 according to the bank reconciliation as at 30 June 2008 represented income or receipts from debtors. I could also not perform reasonable alternative procedures to obtain all the documentation and explanations deemed necessary to classify the deposits. Therefore I could not determine whether the income recorded was complete and whether the valuation of receivables and payables were correct.

Payables

7. I was unable to obtain sufficient appropriate audit evidence as to the existence, obligations and valuation of unspent balances of grants and subsidies received and insurance receipts amounting to R5 535 201 and R159 637, respectively, that were included in payables amounting to R22 470 889 as disclosed in the balance sheet and in note 15 to the financial statements. Due to the lack of sufficient appropriate audit evidence there were also no reasonable alternative procedures that I could perform. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.

Receivables

8. Due to the lack of sufficient appropriate audit evidence I was unable to perform all the procedures or obtain all the documentation deemed necessary to obtain adequate audit assurance as to the existence, valuation and rights for debtor balances amounting to R621 720, included in receivables amounting to R2 638 271 as disclosed in the balance sheet and in note 11 to the financial statements. Due to the lack of supporting documents and records no alternative procedures could be

performed. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for receivables.

Accumulated surplus or deficit

9. Sufficient appropriate audit evidence for transactions amounting to R2 973 956 that were credited to the appropriation account, was not available. Adequate audit assurance as to the occurrence, accuracy and classification of these transactions could thus not be obtained. No alternative procedures could be performed due to the absence of supporting documentation and proper referencing in the financial system.
10. According to the applicable basis of accounting, prior year adjustments should be accounted for in the appropriation account. Trade creditors and expenditure that were incorrectly recognised when orders were placed during the previous financial year were corrected during the current financial year. The correction of expenditure amounting to R634 925 was, however, not accounted for in the appropriation account, but the expenditure for the current year was reduced. As a result expenditure was understated and the net surplus for the year was overstated by R634 925 in the income statement.

Revenue

11. Electricity tariffs which were not approved by the National Energy Regulator (NER) were charged to consumers during the year. Since no approval existed, the previous year's tariffs should have been used, resulting in revenue being overstated by R911 907. As at the date of my audit report, management was still in the process of negotiating with the NER regarding the electricity tariff applied. I was unable to determine by alternative means whether any adjustments might have been necessary to revenue as disclosed in the income statement and receivables as disclosed in the balance sheet and note 10 to the financial statements.
12. Valid contracts or agreements in support of the leasing of municipal properties could not be submitted. Records to ensure that the revenue from traffic fines was accurate and complete were also not available. I was thus unable to obtain adequate audit assurance as to the completeness, occurrence, accuracy and classification of revenue from rent and traffic fines amounting to R1 870 664 and R78 050 respectively that were included in the revenue of R124 189 671 as disclosed in the income statement.

Irregular expenditure

13. As a result of the supply chain management regulations not being adhered to, the municipality incurred irregular expenditure amounting to R786 576 during the year. This irregular expenditure was not disclosed as irregular in the financial statements as required by section 125 (2)(d) of the MFMA.

Contingent liabilities

14. Instances existed where former employees had instituted proceedings against the municipality for unfair dismissal which was still under arbitration. Although disclosed in note 36 to the financial statements, the nature, extent and financial effect of these contingent liabilities could not be determined due to a lack of information and

supporting evidence. Alternative procedures performed to obtain the information from external sources were also not successful.

Disclaimer of opinion

15. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Nketoana Local Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matter:

Irregular, fruitless and wasteful expenditure

16. As disclosed in note 33 to the financial statements, fruitless and wasteful expenditure to the amount of R106 400 and irregular expenditure to the amount of R78 4601 was incurred during the financial year.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

17. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property Plant and Equipment	X		X		X
Cash and cash equivalents			X		
Payables			X		
Receivables			X		
Accumulated surplus/deficit			X		
Revenue			X		X
Irregular expenditure			X		
Contingent liabilities			X		

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

Non-compliance with applicable legislation

Municipal Finance Management Act

18. The council did not adopt resolutions setting measurable performance objectives for revenue from each source and each vote and approving changes to budget-related policies, together with the adoption of the budget as required by section 24(2)(c) of the MFMA.
19. No evidence existed that irregular, fruitless and wasteful expenditure incurred in previous financial years to the value of R1 049 287 was to be recovered or, after investigation by a council committee, certified by the council as irrecoverable and written off by the council.
20. Contrary to section 45 of the MFMA evidence that the municipality's overdraft facility of R2 000 000 was approved by council could not be obtained.
21. Contrary to section 62(1)(c) of the MFMA the municipality did not maintain effective, efficient and transparent systems of risk management and internal control.
22. Contrary to section 65(2)(j) of the MFMA bank reconciliations were only performed at year-end and not on a monthly basis.
23. No indication existed that the National Treasury was informed of the arrear accounts of other state organs amounting to R5 336 226 as required by section 64(3) of the MFMA.
24. The provincial treasury was not informed of the failure by the municipality to adopt and implement a budget and supply chain management policy as contemplated in section 73 of the MFMA.
25. The municipality has not adopted and implemented its draft supply chain management policy for the year under review as required by section 111 of the MFMA.

26. The annual report for the 2006-07 financial year has not yet been prepared and adopted by the council in accordance with sections 121(1) and 127 of the MFMA.
27. The matters raised in the prior year audit report were not adequately addressed as per section 131(1) of the MFMA.

Municipal Systems Act

28. Councillors did not complete updated financial disclosure forms in the year under review as required by schedule 1 of the MSA.
29. Performance contracts with managers have not been concluded and/or revised as required by section 57 of the MSA.

Matters of governance

30. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.		X
• The audit committee operates in accordance with approved, written terms of reference.		X
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	X	
• The internal audit function operates in terms of an approved internal audit plan.		X
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		X
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.	X	
• The prior year's external audit recommendations have been substantially implemented.		X
• The Provincial SCOPA resolutions have been substantially implemented.		X
Implementation of Standards of Generally Recognised Accounting		

Matter of governance	Yes	No
Practice (GRAP)		
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007. 	X	
<ul style="list-style-type: none"> The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP. 		X
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008. 	X	

Unaudited supplementary schedules

31. The supplementary information set out on pages [XX] to [XX] of the financial statements does not form part of the financial statements and is presented as additional information. I have not audited this schedule and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

32. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

33. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

Responsibility of the Auditor-General

34. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
35. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
36. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

No reporting of performance information

37. The municipality has not reported performance against predetermined objectives, as required by section 41 of the MSA.
38. The municipality did not develop and implement a performance management system, as required by regulations 7 and 8 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (*GNR 796 of 2001*) and sections 38 to 42 of the MSA.

Integrated development plan (IDP)

39. A process was not adopted which would set out in writing guidance on the planning, drafting, adoption and review of the municipality's IDP, as required in terms of section 28(1) of the MSA.
40. The municipality did not afford the local community at least 21 days to comment on the final draft of its IDP before the plan was submitted to council for adoption, as required by regulation 15(3) of the Municipal Planning and Performance Management Regulations, 2001.
41. The public was not notified within 14 days after the adoption of the IDP, that the IDP has been adopted and that copies of, or extracts from, the plan are available for public inspection at specified places as required by section 25(4) of the MSA.
42. A forum was not established to enhance community participation in the drafting and implementation of the IDP and the monitoring, measurement and review of the municipality's performance in relation to the key performance indicators and performance targets set by the municipality, as required by regulation 15(1) of the Municipal Planning and Performance Management Regulations, 2001 and section 28(2) of the MSA.

No service delivery and budget implementation plan

43. The municipality did not develop and implement a service delivery and budget implementation plan (SDBIP) for the period under review, as required by section 69(3) of the MFMA.

Proper functioning of a performance audit committee

44. The audit committee, which was also appointed as the performance audit committee, was not fully functional during the year as it did not meet at least twice where a quorum was present and did not make recommendations regarding a performance management system to the council of the municipality, as required by regulation 14 of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

45. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal auditing processes as required in terms of section 45 of the MSA and section 165(2)(b)(v) of the MFMA.

Mid-year performance assessment not performed

46. A report by the accounting officer on mid-year budget and performance assessments, as required by section 72 of the MFMA was not performed.

General key performance indicators not included in the IDP

47. The municipality did not set appropriate key performance indicators and targets as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its IDP, as required by regulations 9 to 12 of the Municipal Planning and Performance Management Regulations, 2001, and sections 41(1)(a), 43 and 44 of the MFMA. The IDP was further incomplete with regard to institutional framework, council's development priorities and objectives, an alignment to the national and provincial sectoral plans and a three-year financial plan.

APPRECIATION

48. The assistance rendered by the staff of the Nketoana Local Municipality during the audit is sincerely appreciated.

Auditor-General

Bloemfontein

30 November 2008



A U D I T O R - G E N E R A L